

The Treasury

Shareholder Expectations Letters Information Release

Release Document

May 2017

<http://www.treasury.govt.nz/statesector/commercial/reporting/strategic>

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- [1] 9(2)(a) - to protect the privacy of natural persons, including deceased people
- [2] 9(2)(b)(ii) - to protect the commercial position of the person who supplied the information or who is the subject of the information
- [3] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice
- [4] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice

Where information has been withheld, a numbered reference to the applicable section of the Official Information Act has been made, as listed above. For example, a [2] appearing where information has been withheld in a release document refers to section 9(2)(b)(ii).

In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.



Office of Hon Todd McClay

MP for Rotorua

Minister of Trade

Minister for State Owned Enterprises

Associate Minister of Foreign Affairs

14 DEC 2016

Mr Stuart McLauchlan
Chair
Dunedin International Airport Ltd
Private Bag 1922
DUNEDIN 9054

Dear Mr McLauchlan

2017/18 SHAREHOLDER EXPECTATIONS OF DUNEDIN INTERNATIONAL AIRPORT LTD

I am writing on behalf of shareholding Ministers to outline the matters we expect the Board of Dunedin International Airport Limited (DIAL) to address in the business planning process for the 2017/18 financial year.

The Government remains committed to driving the shift towards more active management of its shareholding in commercial assets (the Crown's Commercial Portfolio). We will continue to engage with Boards on how to best maximise the value of the Crown's commercial businesses through improved performance and effective capital management in line with the expectations set out in this letter.

This letter contains the following information:

- Ministers' specific expectations for DIAL
- General expectations for the Crown's portfolio of commercial investments (the Commercial Portfolio)
- The timetable for the business planning process this year (refer to Annex 1), and
- Summary analysis of the performance of the Commercial Portfolio, which DIAL is part of (refer to Annex 2).

Entity specific expectations

Health and Safety

We expect that a key priority for the business remains the health and safety and efficient operation of both aeronautical and other commercial divisions of the airport.

Generation of a Commercial return

Consistent with section 4(3) of the Airports Authorities Act 1966 (the Act), airports “operated or managed by an airport authority must be operated or managed as a commercial undertaking”. We therefore expect that:

- DIAL’s business plan (and pricing) includes a commercial return on the equity shareholders have invested in the airport i.e. the airport returns its cost of equity, and
- an appropriate proportion of that return is paid to shareholders as a dividend.

Redevelopment of terminal building and baggage hall

We understand that DIAL is currently redeveloping the baggage handling system, as well as exploring options for further expansions of the departures and other passenger areas. We expect that the Treasury will be provided business case materials supporting these expansions ahead of works commencing. In addition, please ensure that any material developments or announcements continue to be conveyed to the Treasury ahead of being announced publicly.

General expectations for the Crown’s Commercial Portfolio

The Crown’s shareholding in DIAL is part of the Crown’s Commercial Portfolio. We set out general expectations of all entities that form the Commercial Portfolio below.

Dividends

Ministers expect positive business performance to result in dividend payments, and that an appropriate balance is maintained between dividends and reinvestment. Our preference is for dividends over new investment.

A statement of the principles adopted by the Board in determining the annual dividend is required to be disclosed in the Statement of Intent (SOI). Further guidance on dividend policy is provided in section 7.6.2 of the Owner’s Expectations Manual (OEM).

Investment

Since 2007, the Crown has made significant capital investment in the Commercial Portfolio. However, the impact to the earnings of the portfolio is not clear. The Treasury is looking to place a greater focus on capital investment over the next financial year. Analysis of the capital investment for the Commercial Portfolio since 2007 is included in Annex 2.

Ministers are focussed on maximising returns from capital invested across the Commercial Portfolio. Accordingly, there is a high threshold for Ministers' support for significant new investment.

In light of this, we expect you to engage with Ministers and the Treasury on DIAL's strategic initiatives as they develop, particularly those that require a meaningful investment of capital. We expect investments to be value enhancing and supported by robust business cases, which: (i) evaluate options thoroughly, (ii) are based on reasonable assumptions, (iii) take into consideration all material risks, and (iv) apply the appropriate risk-adjusted cost of capital.

Capital Structure

Ministers expect that the Board will periodically review the capital structure of the entity to ensure that it is: (i) appropriate for the entity, and (ii) any borrowing is maintained at a prudent level. Entities are expected to return any surplus capital to the Crown so that it may be used to fund other Crown priorities.

CFISnet Submissions

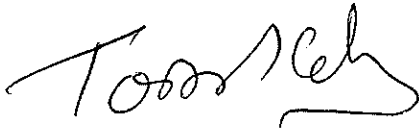
CFISnet is the means by which DIAL provide monthly and quarterly financial information to the Treasury which is used for reporting and analysis prepared for Ministers. We request that you encourage DIAL management to ensure that any information filed is appropriately reviewed prior to submission.

Engagement

The Treasury is working to engage more closely with entities to gain a better understanding of the strategic issues, risks and influences on entities' financial performance. In light of this closer engagement, I would like the Board to meet with the Treasury to discuss this letter of expectations at an appropriate time in the New Year.

Your Treasury relationship managers will be in contact shortly after you receive this letter to discuss Ministers' expectations in more detail. If you have any questions please contact [1] or Aaron Gill (on [1]). Alternatively, please contact Angela Graham (Manager, Commercial Advice) on [1]

Yours sincerely

A handwritten signature in black ink, appearing to read 'Todd McClay', with a stylized flourish at the end.

Hon Todd McClay
Minister for State Owned Enterprises
on behalf of shareholding Ministers

cc: Mr Richard Roberts, CEO, Dunedin International Airport Limited

Mr Gavin Logie, Dunedin City Holdings Ltd, PO Box 5045, Dunedin 9016

Annex 1

Timetable for the Business Planning Process for 2017/18

<i>Due Date</i>	<i>Key Action</i>
1 March	Board sends strategic issues letter to Ministers
1 March	Board submits draft SOI and business plan
30 June	Board delivers final SOI to shareholding Ministers

DIAL is expected to provide shareholding Ministers with a strategic issues letter by **1 March 2017**, setting out the key strategic issues facing the company. Should your company wish to engage with shareholding Ministers to seek clarification around their expectations, we would ask that you advise the Treasury as early as possible of such intentions.

DIAL is expected to provide shareholding Ministers with a draft SOI and Business Plan, consistent with the expectations as detailed in this letter, by **1 March 2017**.

The final SOI should be delivered to shareholding Ministers on or before **30 June 2017**.

Shareholding Ministers should be alerted as soon as possible if any of these deadlines cannot be met.

Further guidance on the timetable is contained in section 5.6.4 of the OEM. The OEM is available from the Treasury's website at:

<http://www.treasury.govt.nz/commercial/publications/guidance/owners-expectations-manual>.

Annex 2: Commercial Portfolio

Chart 1: Revenue (FY16) % of Commercial Portfolio

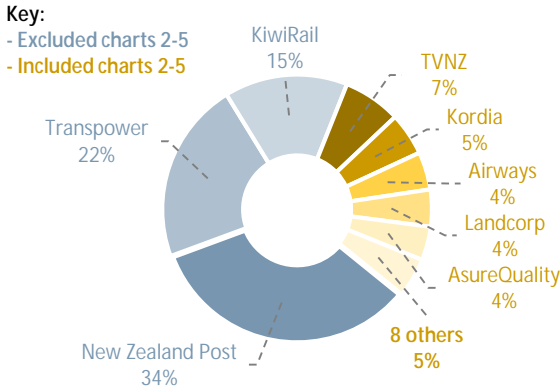


Chart 2: Purchase of fixed assets¹

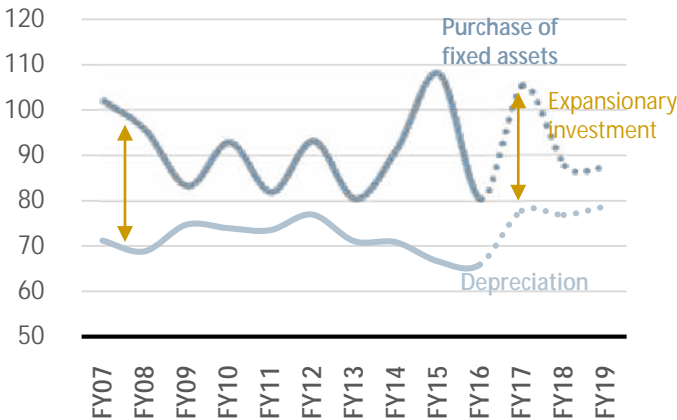


Chart 3: Sources & uses of cash (\$bn, FY07-FY16)²

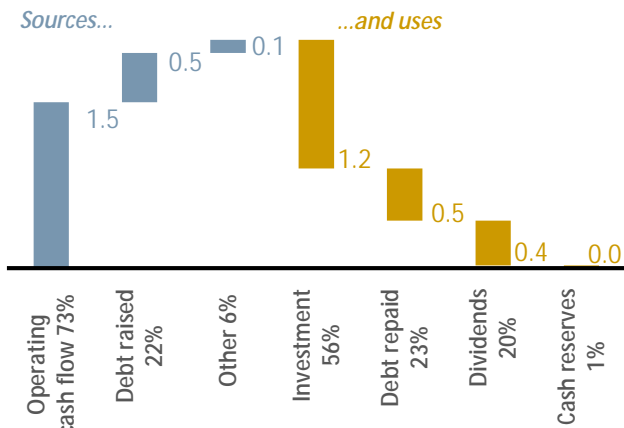


Chart 4: Dividend yield

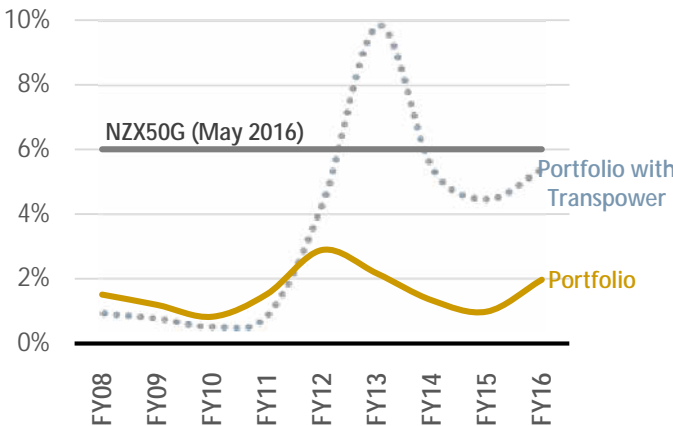
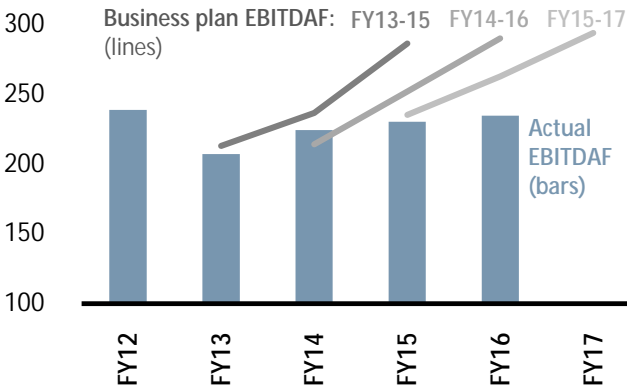


Chart 5: EBITDAF (\$m)



Commentary

The Commercial Portfolio comprises 17 companies with a combined commercial value of \$5.8bn*. 11 are State-owned Enterprises and the remaining six have a primary commercial objective (note MOM companies are not included).

The charts above present the following observations:

- Chart 1: The largest three companies account for 71% of the portfolio's revenue.

Charts 2-5 focus on the remainder of the portfolio*:

- Chart 2: Purchases of fixed assets have been above depreciation levels suggesting expansionary investment
- Chart 3: Over 50 cents per dollar of total cash inflows was applied to investment, and only 20 cents to the payment of dividends
- Chart 4: The outcome is a dividend yield below the market and shareholder expectations (1-3%). Transpower makes the most significant contribution to the portfolio's dividend payments
- Chart 5: Investment performance rarely meets original expectations. Earnings were broadly flat despite recent investment

All data is sourced from ComOps CFISnet

* Charts 2-5 exclude the largest companies; NZ Post, Transpower and KiwiRail. This is done to demonstrate that observations around heavy investment and the adequacy of returns are not just driven by a few larger entities, but are also applicable to the remainder of the portfolio. Including these companies would exacerbate all of our observations except chart 4 (as Transpower lifts the portfolio yield substantially).

¹ Chart 2 excludes Landcorp since many of its fixed asset purchases relate to land development, which is not depreciated. ² Chart 3 excludes Public Trust due to financial institutions having large debt movements.